

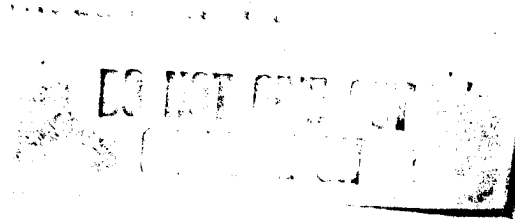


Director
Central
Intelligence

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Peru: Economic and Political Prospects



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*NIE 97-84
November 1984*

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PERU: ECONOMIC AND
POLITICAL PROSPECTS

Information available as of 30 October 1984 was used in the preparation of this Estimate, which was approved by the National Foreign Intelligence Board on that date.

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THIS ESTIMATE IS ISSUED BY THE DIRECTOR OF CENTRAL INTELLIGENCE.

THE NATIONAL FOREIGN INTELLIGENCE BOARD CONCURS, EXCEPT AS NOTED IN THE TEXT.

The following intelligence organizations participated in the preparation of the Estimate:

The Central Intelligence Agency, the Defense Intelligence Agency, the National Security Agency, and the intelligence organizations of the Departments of State and the Treasury.

Also Participating:

The Assistant Chief of Staff for Intelligence, Department of the Army

The Director of Naval Intelligence, Department of the Navy

The Assistant Chief of Staff, Intelligence, Department of the Air Force

The Director of Intelligence, Headquarters, Marine Corps

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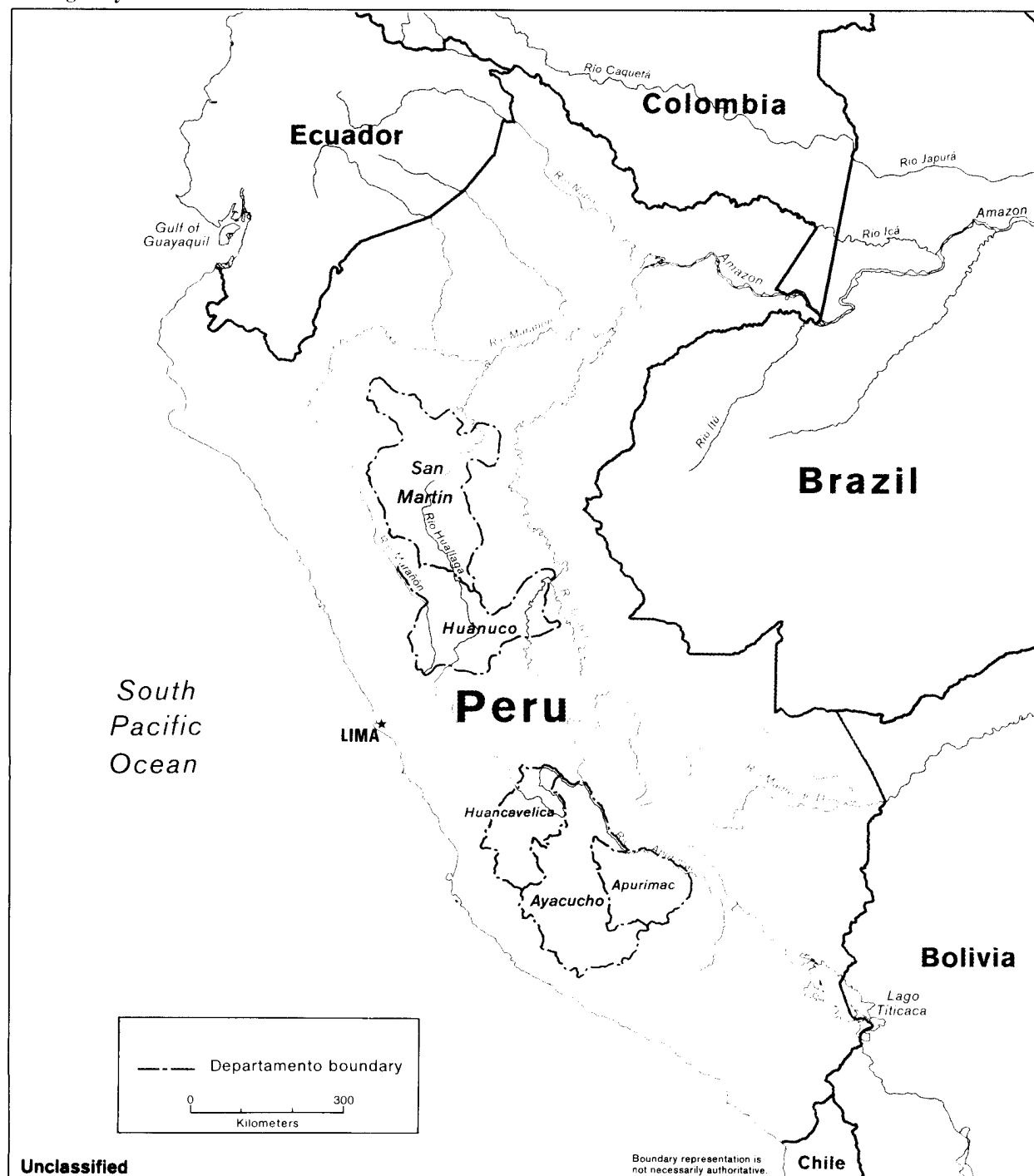
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SCOPE NOTE

National elections, including one for the presidency, are scheduled to be held in Peru in April 1985. This Estimate looks at who the likely winner will be and how he may handle Peru's pressing political and economic problems. These include the worst recession in modern Peruvian times, difficult relations with the country's foreign creditors because of a massive foreign debt, and a four-year-old insurgency that shows little signs of waning. Peru is the only country in South America with which the Soviet Union has an arms supply and military advisory relationship. The Estimate examines whether the results of the election are likely to affect this relationship. It also assesses the significance of election developments for Peru's relations with Cuba and, especially, the United States. The period of the Estimate is the next year or two. ☐

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Figure 1 Emergency Zones



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KEY JUDGMENTS

The popularity of the administration of Peruvian President Belaunde, and the election prospects of his center-right Popular Action (AP) Party, are in sharp decline. At this point, a victory by the center-left American Popular Revolutionary Alliance (APRA) appears likely in the general elections scheduled for April 1985. We believe that the military will permit the APRA candidate, Alan Garcia Perez, to take office. Although the limits of their tolerance for radical government are not fully known, the armed forces probably would intervene only in the unlikely circumstance of a victory by the radical leftist United Left (IU) coalition or if the IU gains significant influence over Garcia in preelection maneuvering. []

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We believe neither the domestic economy nor government management of Peru's serious foreign debt problem is likely to improve in the next year or so, regardless of who wins the election. Once in office, the worst rhetorical excesses of the APRA—which in its preelectoral pronouncements emphasizes statist economic solutions and appeals to national resentment against foreign banks, the International Monetary Fund (IMF), and the United States—probably would fade. But an APRA government would be even less likely than the current administration to make the reforms necessary to stabilize the economy and restore prospects for growth. Moreover, an APRA government would be a more difficult negotiating partner for the United States. Debt negotiations would be particularly trying. Although outright debt repudiation is highly unlikely, there is already some risk that the Belaunde administration will abandon IMF programs, declare a moratorium on debt service payments, and try to deal directly with major banks. This risk would become more substantial under an APRA government.¹ []

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We believe that an APRA government probably would expand contacts with the Soviet Union and Cuba, and possibly with China. It also probably would open diplomatic relations with North Korea. The Peruvian armed forces almost certainly will continue to buy military equipment from the Soviets, but budgetary limitations are likely to

¹ Treasury believes that an APRA government, with elections behind, would gradually move to address the economic crisis. Agreement with the IMF by the end of 1985 or early 1986 is possible. In any event, Treasury would expect a new government to end the paralysis in decisionmaking which currently characterizes the Belaunde administration. []

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impose some limits on Soviet arms imports. They also probably will continue to send Peruvian military personnel to the Soviet Union for training, thereby offering additional possibilities to the Soviets for making inroads into the Peruvian military. Diplomatic relations probably would be quickly restored with Cuba. Nevertheless, neither the Cubans nor the Soviets are likely to supply the substantial economic assistance that would be necessary for them to win significant political influence in Peru. [REDACTED]

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In relations with the United States, an APRA government probably would be markedly less pro-American than the Belaunde administration. Nonetheless, while Garcia might place more emphasis on following a nonaligned foreign policy, we believe he would be unlikely to make substantive changes that would drastically alter Lima's traditionally pro-Western orientation. His foreign policy platform is still in the formative stages, however, and he is a young and inexperienced politician who may be more subject to radical leftist pressures than presently seems likely. [REDACTED]

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Garcia has already assured US officials that he would continue bilateral cooperation in such key areas as narcotics control, but we believe he would have no more success in reducing the flow of cocaine to the United States than has the Belaunde government. [REDACTED]

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Prospects for resolving Peru's insurgency are also not good. While the major insurgent group, *Sendero Luminoso* (Shining Path), has deep roots in isolated rural areas where the government has long been neglectful, it probably cannot evolve into a national movement because its rigid Maoist ideology limits its popular appeal and its chances of receiving foreign assistance. Over time, its actions may result in an increasing cycle of violence by both sides that could further polarize the population. Furthermore, it probably would not come to terms with any government, even one formed by the IU. [REDACTED]

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There is a chance—which we consider highly unlikely—that sharply higher levels of leftist influence may occur in Peru over the term of this Estimate. This would most likely come about:

- If the IU wins and the military fails to intervene.
- Or if, in response to military intervention, widespread violence and political opposition enabled the radical left to initiate an insurgency that eventually receives much broader support than *Sendero Luminoso* has.

Either of these two circumstances would provide potentially greater opportunities for growth of Soviet and Cuban influences in Peru and, perhaps, in the hemisphere. [REDACTED]

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Although the above Key Judgments represent the best estimate of the Intelligence Community, there are information gaps which add a degree of uncertainty to our judgments in three major areas. First, while reporting indicates the Peruvian military hierarchy remains relatively conservative and anti-Communist in outlook, much less is known about the attitudes of younger officers who may have been exposed to Soviet influence. Secondly, we have little information on popular attitudes and support for *Sendero Luminoso* in areas where it has a foothold, so we cannot be certain about its ability to spread rapidly to other areas. Finally, we also lack sufficient intelligence on the impact of pervasive drug corruption on Peruvian institutions and the consequent potential implications to be confident that this will not become a serious problem over the period of this Estimate.

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DISCUSSION

1. National elections, including one for the presidency, are scheduled to be held in Peru in April 1985, with a subsequent runoff election if there is no majority winner. The country is in the grip of its worst economic recession in modern times, brought on by the global recession, massive foreign debt, extraordinarily bad weather last year, and many years of poor economic management. As a result, the popularity of the present center-right administration as well as the ruling party's presidential election prospects are in sharp decline and, at this point, a victory by the center left in the next year's elections seems likely. [REDACTED]

The Political Scene

2. There is little chance that the administration of President Fernando Belaunde, leader of the center-right Popular Action (AP) party, can engineer a political and economic turnaround in time to repair his party's electoral fortunes. Instead, it now seems likely that the center-left American Popular Revolutionary Alliance (APRA) will take over the reins of government. Another major political force that will put forth a candidate for president is the United Left (IU) coalition, a leftist political front consisting of six member organizations that backed Marxist lawyer Alfonso Barrantes Langan in his successful attempt to become mayor of Lima in the municipal elections in November 1983. Luis Bedoya Reyes, leader of the center-right Popular Christian Party (PPC), rounds out the field of major presidential aspirants. [REDACTED]

3. APRA has traditionally been the largest, best organized political party in Peru. Until fairly recently, however, it was perceived by the Peruvian military, its traditional opponent, as too radical to hold power. This led the armed forces in 1962 to annul the presidential victory of the founder of APRA, Victor Raul Haya de la Torre, and to seize power for itself in 1968 when it appeared that Haya de la Torre was about to win the presidency from Belaunde at the end of the latter's first term in office. Since Haya de la Torre died in 1979, however, the mainstream of APRA has moved closer to the center, calming military fears. [REDACTED]

4. APRA now consists of a moderate majority led by Secretary General Alan Garcia Perez, who will be the party's candidate for president next year, and a more radical minority wing led by APRA's defeated 1980 presidential candidate, Armando Villanueva del Campo. Although Garcia has succeeded in revitalizing APRA since its poor electoral showing in 1980, tensions still exist between the party's two factions. Nevertheless, Garcia is young, popular, and charismatic, and Villanueva has publicly endorsed his candidacy. Moreover, though Villanueva is attempting to strengthen the influence of the left within APRA, Garcia probably has enough support within the party to meet the challenge. [REDACTED]

5. Garcia's principal opponent in the 1985 race is likely to be the IU's Barrantes, despite his notable lack of success as Lima's first Marxist mayor. The groups that make up the IU—including the Popular Democratic Unity Front (UDP), the Moscow-line Communist Party, Maoists, Trotskyites, and Socialists—have been plagued in the past by doctrinal disputes and personal infighting. Under Barrantes's leadership, however, the IU made a good showing in the municipal elections in November 1983. He is probably seen—correctly—as the only far-left candidate who can keep the IU from falling apart over its ideological and personality differences. [REDACTED]

6. The third major candidate in the race will be AP Secretary General Javier Alva Orlandini. The party's recent failure to form an electoral alliance with the PPC, however, virtually negates any chances for success next April. Efforts to reconstruct the coalition that brought President Belaunde to power four years ago foundered because both sides insisted that their respective standard bearers head the ticket. For his part, although the PPC has no chance of winning in 1985, Bedoya reasons that his party will emerge as the main opposition force on the center right if the AP remains divided. We believe the major beneficiaries of the center's inability to unite will be Garcia and Barrantes. [REDACTED]

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7. Another actor of major consequence on the political scene is the military. Throughout the 20th century, the armed forces have regularly intervened in political affairs, often removing presidents or preventing them from taking office when the officer corps disagreed with their political orientation or policies. The intervention of the armed forces in 1968, which resulted in 12 years of military rule, had several significant consequences for the current political situation. First, the government of Gen. Juan Velasco Alvarado undertook ambitious reforms aimed at increasing popular participation in the political, economic, and social life of the country and curbing the power of the white, urban-based elite. One of the legacies of the military government is a more militant, politically conscious rural and urban proletariat which, in recent elections, has voted in increasing numbers for leftist parties. A second legacy stemming from these reformist tendencies was the massive strengthening of state control over the economy through nationalizations of foreign enterprises and the wholesale creation of state-owned businesses and financial institutions.

8. The third important result of the military's 12 years of government was the officer corps' realization that Peru's problems are intractable and that service as the country's ruling power had a divisive, corrupting effect on the military as a professional institution. This led the armed forces to return power to the civilians with Belaunde's election in 1980 and has resulted in a greater reluctance than in the past to seize governing authority again so quickly. Nonetheless, the military is maintaining a close watch over the civilian political process, and top officers maintain that they would intervene again if they felt such action necessary to prevent political chaos or a radical turn to the left.

9. A fourth consequence of military rule was that even though Peru's military leaders are anti-Communist domestically, their strong nationalism has led them to raise Peru's profile internationally on Third World issues and to develop closer diplomatic, economic, and, especially, military relationships with the Soviet Union. Because the United States refused to sell them advanced fighter aircraft, Peru, in the early 1970s, turned to the USSR as its primary arms supplier. Lima wanted increasingly sophisticated weapons in order to outclass the military forces of its neighboring rivals, Chile and Ecuador. Moscow, for its part, probably expected to gain leverage on Peru's foreign and domestic policies, earn badly needed foreign exchange, and gain a foothold for selling military equipment to other South American countries.

10. Both sides appear to have achieved some of their aims through this continuing arms supply relationship. Peru's Soviet hardware has made its armored and air forces superior to those of its neighbors. Moscow's gains include the sale of approximately \$1.6 billion worth of hardware and technical assistance, exposure of 2,000 to 3,000 Peruvian military personnel to training in the USSR, the presence of Soviet advisers and technicians in Peru, and a virtually captive market for spare parts and maintenance services.

11. It is logical to assume that the Soviets have made some inroads among the Peruvian military over the past decade, but we lack evidence that this is the case. In fact, the diplomatic and political impact of Soviet military aid appears to have been relatively small. Peru, while still following its nonaligned course, has taken few pro-Soviet positions in the international arena. Moreover, Peruvian armed forces personnel trained in the USSR have not become noticeably pro-Soviet, and Soviet advisers in Peru have no apparent influence outside their areas of military expertise. Regionally, Moscow has been unable to capitalize on its Peruvian connection to induce other South American military establishments to purchase weapons from the USSR. (See table 1.)

Crucial Problems Facing the Government

12. *Economic.* The Belaunde administration has been struggling with a great many problems, but several of the most difficult are how to reverse the rapid decline that has occurred in the economy, how to cope with Peru's giant foreign debt, how to defeat a four-year-old insurgency, and how to curb a narcotics industry that is undermining government authority in large areas of the country. Its inability to address any of these problems satisfactorily has been a major cause of its present unpopularity. But any successor administration will have a similarly difficult time managing these problems because they are rooted in longstanding political, economic, and social trends that will not be easily changed.

13. Economically, 1983 has been called Peru's worst year of the century. (See figures 2 and 3.) GDP fell by nearly 12 percent, real wages dropped, unemployment and underemployment rose to possibly as high as 60 percent, and a large number of banks and businesses went bankrupt. Some of the causes of this decline were totally beyond the government's control. A climatological phenomenon known as "El Nino," for example, simultaneously caused torrential rains and flooding in northern coastal areas and drought in the south, which destroyed agriculture and infrastructure.

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Modernization Efforts of the Peruvian Armed Forces

Over the past decade or so, Peru's extensive arms purchases from the Soviet Union and the West have enabled it to become the dominant military power in Andean South America. Peru's conventional superiority probably would enable it to defeat either Chile or Ecuador, its principal rivals, in a strictly bilateral conflict. In the unlikely event of a two-front war—the basis upon which Peru formulates its plans and requirements—it probably has sufficient strength to defend one frontier while conducting effective offensive operations on the other. []

The armed forces' current strength is the product of a major expansion and modernization effort that began in the early 1970s. The Army has almost doubled in size since 1973 to 75,000 men, making it the third largest in South America—behind Brazil and Argentina—almost as large as the combined armed forces of Chile and Ecuador. During the same period the Air Force has

grown from about 7,000 men to its current size of 40,000; it ranks third behind Brazil and Argentina in total number of combat aircraft. The Navy has kept pace with the other two services by developing South America's third-largest surface fleet and the region's largest submarine force. []

Peru turned to the USSR as a source of military hardware following the coup in 1968 that brought leftist Army officers to power. From 1973 to 1980 the Soviets became Peru's single largest military supplier by delivering over \$1 billion worth of equipment to the Army and Air Force, about half of all Peruvian arms purchases. Accompanying this equipment were Soviet military and technical advisers, who presently number about 150. [] In addition, we estimate that some 2,000 to 3,000 Peruvian military [] personnel have been trained in the USSR since the mid-1970s. []

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It also further damaged an already-declining fishing industry. Other external factors which buffeted the economy in 1983 were high real interest rates and the world recession, which caused a sharp decline in demand and prices for Peru's oil and copper exports. These externally caused problems were compounded by domestic policy decisions, such as the refusal to cut back on heavy public expenditures for military equipment and infrastructure improvements, that had no short-term payoff. []

14. By early 1984, Peru's debt problem had worsened to the point that its relationship with the international financial community is threatened. Peru owes at least \$13 billion to foreign public and private sources and is having great difficulty servicing its debt obligations. International financial concern over Peru's political situation—as well as general concern about the debt problems of Latin America—has further eroded confidence in Lima's ability to meet its obligations and has caused foreign banks to become extremely reluctant to commit new money. Governments in the Paris Club and foreign banks have insisted that Peru reach and maintain agreement on a stabilization program with the IMF before they will make new money available or even reschedule existing debt. (See table 2.) []

15. An agreement with the IMF was reached in April, but Belaunde has been unable to make the many politically difficult domestic policy adjustments, such as reducing government spending, that would be

necessary to comply with the terms of the agreement. Moreover, pressures from influential interest groups to relax austerity have already caused Peru's fiscal deficit, currently projected at 10 percent of GDP, to exceed the 4.1-percent IMF target. (See figure 4.) The protracted delay in meeting IMF demands has jeopardized the pending debt-refinancing package and has cut access to foreign credit. Payment arrearages almost certainly will mount in coming months. []

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16. *Social and Political.* The emergence of an indigenous Maoist guerrilla group in 1980 has imposed a third costly burden on Belaunde's beleaguered administration. The group, which is known as *Sendero Luminoso* (Shining Path), engages in rural and urban terrorism, particularly in the south-central Andean departments of Ayacucho, Huancavelica, and Apurimac; in and around Lima; and, most recently, in the north-central departments of Huanuco and San Martin. *Sendero Luminoso* has caused considerable death and violence, and some disruption, in the isolated mountain areas where it has gained a foothold. These regions have long been neglected and ignored by the central government. Nevertheless, the impact of the insurgency on the general population has been relatively minor, except for some instances of urban terrorism and sabotage. []

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17. The impunity with which *Sendero* operates outrages most Peruvians, who have demanded that the government take strong measures to contain it. Belaunde was extremely reluctant to turn the problem

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**USSR-Peru: Military Agreements
Deliveries and Advisers/Technicians
1973-30 June 1984**

Year	Agreements (Million US \$)	Deliveries (Million US \$)	Advisers/ Technicians in Peru
1973	200	40	15
1974	3	26	20
1975	70	69	35
1976	337	95	30
1977	250	368	100
1978	0	237	100
1979	200	23	100
1980	105	129	150
1981	118	50	100
1982	106	90	125
1983	204	92	150
1984 (First half)	0	137	150
Total	1,593	1,356	Not applicable

Since his return to power in 1980, pro-Western President Belaunde and many senior Army and Air Force officers have sought to reduce Peru's dependence on the USSR, but this effort has had mixed results. After US export restrictions prevented the Peruvians from acquiring the US AH-1 Cobra attack helicopter, Lima contracted for almost \$120 million worth of Soviet weapons in 1981. In 1982 the Peruvian Air Force agreed to buy 26 Mirage 2000 fighters from France, but delivery of the aircraft has been stalled by Peru's inability to pay. Although Peru continues to express an interest in US weapons systems such as Blackhawk helicopters, M 113 armored personnel carriers, and M-60 tanks, lack of competitive financing remains a major obstacle.

The continued attractiveness of Moscow's concessionary terms could result in new purchases of Soviet equipment.

strongly pro-Western Peruvian Navy, which heretofore has avoided purchasing Soviet equipment, recently has demonstrated interest in purchasing Soviet equipment.

over to the armed forces because he feared that such involvement might tempt the military to move back into politics, possibly ousting him as it did in 1968. Nonetheless, in December 1982 he declared a large part of the Ayacucho region an emergency zone, giving the local military commander civil as well as enhanced military authority in the area. So far, government and guerrilla forces have fought to a standoff in the emergency zone, with the guerrillas recruiting enough new members to replace just about as many as the government can kill. At the same time, the more intense counterinsurgency campaign has stimulated a public outcry against alleged human rights violations by security forces. *Sendero* attacks outside the emergency zone also have increased, prompting the military to create a new emergency subzone in southern San Martin Department and Huanuco Department. Despite this, the *Sendero Luminoso* movement does not at this point possess sufficient numbers, resources, or popular support to threaten the government directly.

18. An additional threat to the government is the Revolutionary Movement Tupac Amaru (MRTA), a small, urban terrorist group which first appeared this year. The organization claimed responsibility for the attack on the US Embassy in Lima on 28 September, and its anti-American propaganda suggests that it will continue to target US installations. The MRTA membership appears to be drawn primarily from urban-based middle-class students and, in contrast to *Sendero*

Luminoso, its actions are focused on political gestures aimed at gaining publicity. Unlike *Sendero*, which shuns all conventional political parties and outside contact, the MRTA would probably welcome support from other groups that share its commitment to a socialist-style revolution. Although there is no evidence to date of foreign funding for the MRTA, because of its orientation it might attract support from Cuba and the USSR.

19. A fourth significant problem that the Belaunde administration faces is the existence of a large and powerful narcotics-producing industry. In December 1983 the Peruvian Interior Minister estimated that enough coca leaf is grown in Peru to produce 250,000 kilograms of semirefined coca paste, most of which is sent to Colombia to be refined into cocaine and then smuggled into the United States. Coca paste sales generate vast sums of money which Peruvian narcotics traffickers use to buy protection throughout the law enforcement and judicial systems and to pay off local politicians. The government has cooperated with the United States in sponsoring coca eradication and crop substitution programs, but these narcotics control efforts have made little headway. Coca cultivation provides a significant portion of the income of most peasant growers, an income they will not voluntarily give up. Moreover, the resources and political clout commanded by the traffickers in the main growing areas often exceed those available to the government.

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Table 1
Peru's Military Strength

Category	Total	Soviet Origin	Combined Chile and Ecuador
Army			
Personnel	86,000		96,400
Armor	406	306	425
APC and ARC	450	32	823
Artillery	420	72	380
Mortars	714	0	1,195
Helicopters	31	26	62
Air defense artillery	154	40	564
Air Force			
Personnel	40,000		18,250
Bombers	12	0	3
Fighter interceptors	17 ^a	0	30
Ground attack	78	51	117
Attack helicopters	14	14	0
Transport helicopters	54	11	33
Fixed-wing transports	56	15	54
Navy and Marines			
Personnel	21,000		29,300
Submarines	12	0	6
Helicopter cruisers	1	0	0
Light cruisers	1	0	2
Destroyers	1	0	8
Frigates	3	0	2
Guided-missile corvettes	0	0	6
Guided-missile patrol boats	6	0	8
Torpedo boats	0	0	7
Amphibious assault ships	7	0	12

^a Twenty-six Mirages on order.

20. In addition to undermining the moral and political authority of the Peruvian Government, the narcotics problem also complicates the government's ability to suppress the *Sendero Luminoso* insurgency. The new front recently opened by the guerrillas in the Upper Huallaga Valley is in a major coca cultivation and trafficking area. Most available evidence indicates that the guerrillas and drug traffickers do not work together and that *Sendero Luminoso* does not finance itself through trafficking. Nonetheless, the guerrillas are attempting to use the Peruvian Government and US antinarcotics programs in the area to enhance their

own fortunes, with peasant coca growers the focus of *Sendero Luminoso* recruitment efforts. Although the narcotics traffickers and the peasants probably would prefer that guerrillas not be active in coca-growing areas because their presence tends to attract a military response, the traffickers may be exploiting opportunities for violence created by the insurgency. A recent raid on a US-sponsored crop substitution facility, for example, appears to have been carried out by narcotics traffickers and mercenaries disguised as guerrillas.

21. These severe problems have developed in a socioeconomic environment that has been one of the least dynamic in Latin America. Much of the Indian population remains outside the modern economy, just managing to subsist. Economic growth has not kept up with the 2.5- to 3-percent growth of the population. The per capita GDP in 1983 was at about the 1963 level. Statist economic policies have created inefficient industries and hampered private activity, except for a large illegal economy which produces not only narcotics but also a large variety of consumer goods and services. The Belaunde administration has tried to free up economic activity, but with only limited success because of opposition from powerful vested interests.

Outlook

22. The elections in April 1985 will be carried out against this backdrop of deeply entrenched economic problems, a severe external financial bind, a stubborn leftwing insurgency, and a virtually uncontrolled narcotics industry. Most observers believe that the APRA candidate will finish in the lead in this first round of voting but that he will not win a majority and, hence, will have to face the second-place finisher—probably the IU candidate—in a runoff election. The likelihood that the congressional vote will be spread among several parties means that APRA's chances of gaining majority control of the legislature do not look good.

23. APRA strategy for winning the second round of elections—that is, whether it will have to appeal to the right or the left—will depend in good part on the political orientation of the other runoff candidate. Given Garcia's relatively moderate orientation, however, he is well positioned to elicit support from the center right if IU makes it to the second round, or from the left in the less likely event that he faces one of the centrist candidates.

24. The odds are that the elections will take place as scheduled and the elected candidate will take office without military interference. There is an outside chance, however, that a sequence of events could

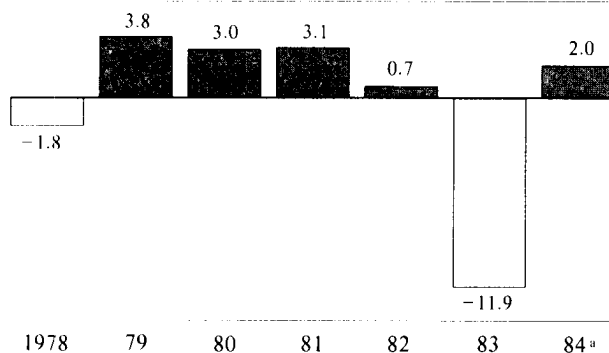
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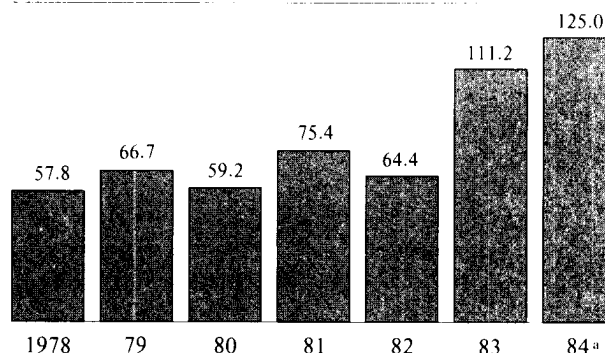
Figure 2
Peru: Selected Economic Indicators

Real Economic Growth

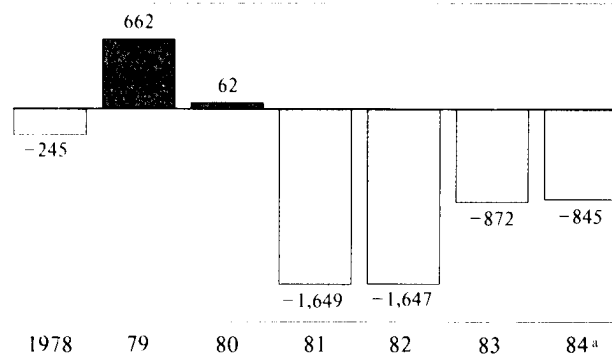
Percent Change

**Consumer Price Inflation**

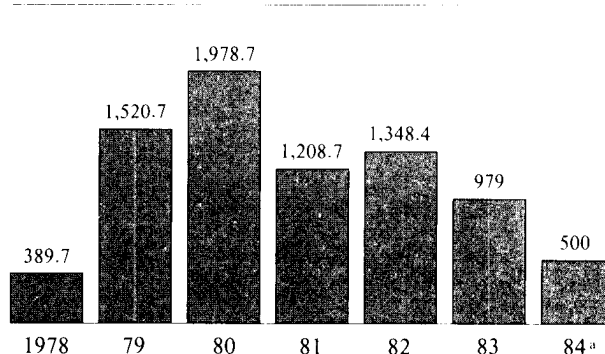
Percent

**Current Account Balance Excluding Official Transfers**

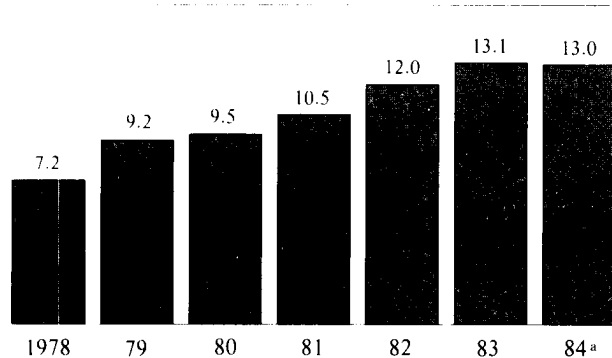
Million US Dollars

**Foreign Exchange Reserves End of Year**

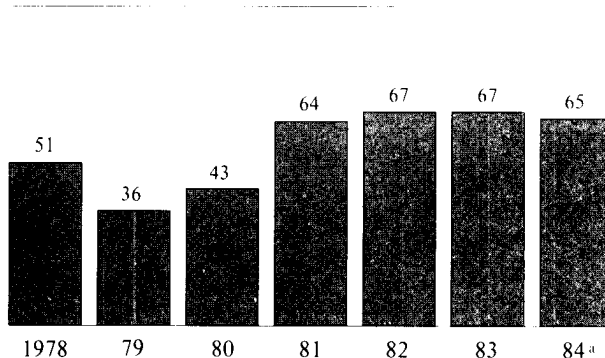
Million US Dollars

**Total Debt**

Billion US Dollars

**Debt Service Ratio**

Percent

^a Estimated.

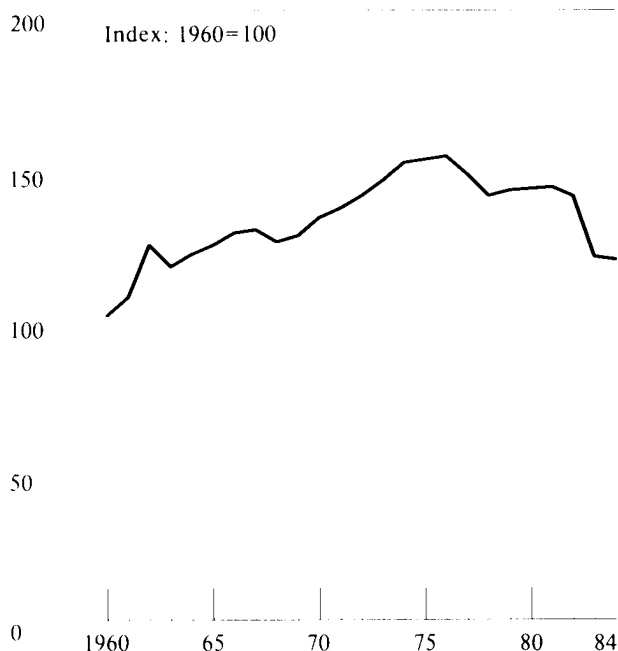
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Figure 3
Peru: Real Per Capita GDP Trend



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develop that would abort a democratic succession and, possibly, even lead to severe instability. The three most likely causes of military intervention would be an unexpected victory by the presidential candidate of the radical left IU, an APRA move toward an alliance with IU to win a runoff election against a centrist candidate, or military inability to accept an APRA victory. We do not believe any of these developments is very likely. We think, however, that the chances are good that the military will not permit the government to fall into the hands of the extreme left, although the limits of their tolerance for radical government are not fully known.

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25. APRA's present strategy is to portray itself as a moderate center-left alternative between the right and the far left. Nonetheless, Garcia has to make some appeal to the left in order to win the presidency, and as elections approach, APRA's domestic policy statements are likely to emphasize statist economic solutions and to draw upon national resentment against foreign banks, the IMF, and the United States. Once in office, however, most of the worst rhetorical excesses would probably fade, although the United States would probably find an APRA government to be a difficult negotiating partner.

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26. One of the areas of greatest difficulty will be debt negotiations. Peru on 5 July missed an interest payment to foreign bankers and is taking an increasingly hard position in talks with the IMF and foreign banks. As the elections approach, the government

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Table 2
Peru: Balance of Payments, 1980-84

US Million \$

	1980	1981	1982	1983	1984 ^a
Current account balance	61	-1,649	-1,647	-872	-845
Trade balance	836	-553	-557	293	575
Exports, f.o.b.	3,898	3,249	3,230	3,015	3,125
Of which:					
Copper	752	529	460	443	494
Oil	777	692	719	544	570
Imports, f.o.b.	3,062	3,802	3,787	2,722	2,550
Net services and transfers	-775	-1,096	-1,090	-1,165	-1,420
Capital account balance	794	1,134	623	1,183	945
Of which:					
Direct investment	21	107	53	38	20
Long-term loans	-125	279	1,057	1,384	970
Short-term capital, errors, and omissions	487	61	467	-588	-365

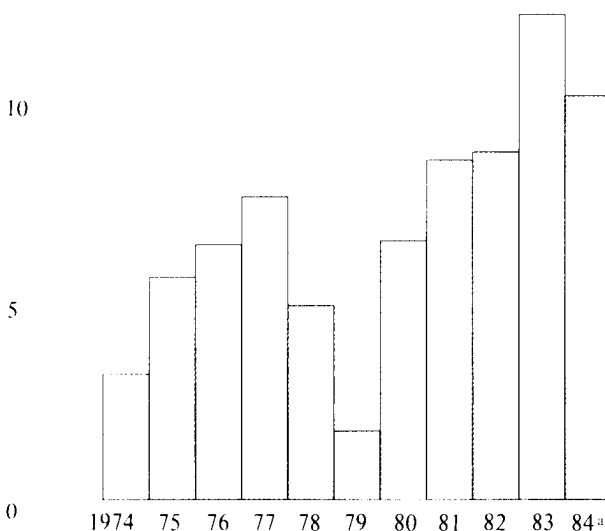
^a Estimated.

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Figure 4
Peru: Government Deficit as a Share of GDP

Percent
15



^a Estimated.

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position is likely to stiffen even further, particularly on accepting some of the stabilization measures and economic performance criteria that the IMF and banks are requiring as conditions for debt negotiation. The current administration is already moving increasingly toward pressure tactics. How far in this direction the government goes will depend in part on whether other Latin American governments take radical actions and what success they have. A center-left APRA government might be even more inclined than the present government to use pressure tactics and, possibly, to coordinate its debt strategy with such similarly inclined countries as Argentina and Bolivia. Although formal debt repudiation is highly unlikely, there is some risk that even the Belaunde administration will abandon IMF programs, declare a moratorium on debt service payments, and try to make the best deal it can by negotiating directly with the major banks. This risk would become more substantial under an APRA government.

27. In terms of its domestic economic policies, an APRA government would be severely constrained by economic realities as well as by the always-present threat of a military coup if it became too radical. Despite its statist rhetoric, it would almost certainly not revert to the statist economic policies of the earlier military government, which widely nationalized enterprises and farms and vastly multiplied state controls over the private sector, because these policies have become broadly discredited. An APRA government would be handicapped, moreover, in its ability to

Status of the Insurgency

The *Sendero Luminoso* (SL) insurgent movement was formed in about 1970, but it did not begin an active campaign of terrorism until a decade later after President Belaunde took power following nearly 12 years of military rule. Between 1980 and 1982, SL grew from a force level of an estimated 250 to 500 armed militants to an estimated 1,000 to 1,500. The SL apparently has not significantly increased its membership since then, but fragmentary evidence indicates that the movement has attracted sufficient new recruits over the past two years to offset combat losses. The leveling off of SL's growth pattern probably reflects a backlash among Indian peasants—the movement's traditional power base—to the increasing brutality employed by the guerrillas.

Spawned in the isolated mountains of south central Peru, the insurgents continue to focus their activities in nine provinces of Ayacucho, Huancavelica, and Apurimac Departments, where the government formed its original Emergency Zone. Earlier this year the insurgents established a new front in the upper Huallaga

River area of San Martin Department, a major coca-growing region, thereby forcing the military to create a second Emergency Zone. Insurgent leaders also have sought to maintain a presence in Lima in an effort to strike a psychological blow against the government and to divert its attention from SL's rural activities. Although SL continues to carry out sporadic terrorist attacks in the capital, the police have greatly weakened its infrastructure there.

We believe that SL does not receive economic or material support from foreign countries or organizations. Although President Belaunde has publicly implied otherwise, we suspect this is intended as a warning to Havana and other potential meddlers to have no contact with Peruvian guerrillas. Lacking support from a foreign sponsor, SL has gathered a heterogeneous collection of small arms, most of which are captured from the police or stolen from government installations, stores, or private owners. The only standard weapon is dynamite stolen from local mines.

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stimulate the needed growth of private enterprise by its political philosophy and predisposition to maintain government primacy over the economy. It also would be even less likely than the present administration to make the reforms necessary to stabilize the economy and restore prospects for growth. As the economic situation deteriorates further over the next year or so, military expenditures to combat insurgency almost certainly will remain a drain on government finances, labor will press for more jobs and wage increases to compensate for rising living costs, and businessmen will demand protection from imports as a relief measure.² []

28. With regard to prospects for the insurgency, *Sendero Luminoso* will pose a continuing, if limited, threat because of its deep roots in isolated rural areas where the government has long been neglectful. The spread of the insurgency to new areas and *Sendero Luminoso's* resiliency against counterinsurgency operations are causing increased public anxiety and military frustration. Moreover, although the guerrillas have alienated highland peasants through persistent brutality, recent abuses against peasants by security forces may also prevent the government from gaining much support in these rural areas. As a result, an escalating cycle of violence by both sides may eventually further polarize the population. []

29. Nonetheless, *Sendero Luminoso* is unlikely to evolve into a national organization. Its rigid adherence to Maoist ideology severely limits its appeal even to the left in Peru and creates a major barrier to receiving support from the USSR, Cuba, or other likely foreign backers of a radical leftist insurgent movement. It is doubtful it would even come to terms with any government, even one formed by the IU. With regard to the MRTA, it does not present a serious insurgency threat at this stage. Nonetheless, its actions could complicate the government's counterinsurgency efforts and adversely affect US interests in Peru. []

30. The prospects are also minimal that an APRA government—or any other administration—will succeed in greatly reducing the amount of coca paste produced in Peru or in diminishing significantly the corrupting influence of narcotics growers and traffickers. The country will not have sufficient resources to undertake such a mammoth task, nor is any government likely to develop the political will or strength to

² Treasury believes that an APRA government, with elections behind, would gradually move to address the economic crisis. Agreement with the IMF by the end of 1985 or early 1986 is possible. In any event, Treasury would expect a new government to end the paralysis in decisionmaking which currently characterizes the Belaunde administration. []

overcome the problem any time soon. At the same time, we doubt the traffickers will seek much greater political power than they already have. As long as they possess enough political influence at the local and regional levels to protect their trafficking activities—as they presently do—they are not likely to divert their resources to attempting to expand their political reach. []

31. In foreign policy matters, an APRA government probably would expand contacts with the Soviet Union and Cuba, and possibly with China, but not in a major way. It also probably would open diplomatic relations with North Korea. The Peruvian Army and Air Force already acquire a large part of their arms from the Soviet Union, but they do not want to become completely dependent on the Soviets, as the current agreement to buy 26 Mirage aircraft from France attests. In fact, the Peruvian military probably would like to expand their arms purchases from non-Soviet sources, but the Soviets offer such beneficial financial arrangements that they generally cannot afford to do so. At the same time, budgetary limitations make it unlikely that Peru will greatly increase its imports of Soviet arms. Moreover, neither the USSR nor Cuba is in a position to provide sufficient economic aid to right the economy. Furthermore, we have no evidence that an APRA government would be receptive to a massive influx of, for example, Cuban teachers or Soviet military and technical advisers. In addition, an APRA government probably would be inhibited from accepting such an influx by fear of a military coup. The Soviets, nonetheless, are assiduously cultivating high-level APRA officials and apparently are disposed to providing APRA with considerable financial assistance in the upcoming elections in the belief that an APRA government would provide them with greater opportunities for influence. An APRA government would probably move quickly to restore full diplomatic relations with Cuba (they are maintained at the charge level now because of various bilateral strains), and those relations are likely to become more cordial. []

US Relations with an APRA Government

32. In relations with Washington, an APRA government would be markedly less pro-American than the Belaunde administration. Garcia probably would place greater emphasis on following a nonaligned foreign policy and—to bolster his Third World credentials—would criticize Washington on a broad range of issues. He also would push to accelerate the currently modest protectionist trend. The content of Garcia's specific policies, however, is extremely difficult to predict. He has been deliberately vague about what he intends to

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do should he win the presidency. Moreover, he is a very young politician and has a short track record from which to forecast his likely behavior. Nevertheless, our best guess is that he is unlikely to make substantive policy changes that would drastically alter Lima's traditional pro-Western orientation. Last June,

[redacted]
[redacted]
[redacted]
[redacted] has acknowledged the importance of US support to democratic government in Peru and has assured US officials that he will continue bilateral cooperation in such key areas as narcotics control.

33. There is a chance—which we consider highly unlikely—that the political situation could drastically worsen, leading to sharply higher levels of leftist influence and, possibly, to instability and violence. None of the principal actors—the military, the APRA party, or even groups on the radical left—are seeking confrontation. The military, for example, aware of the disastrous impact of its earlier policies, says it does not want to take political power again unless absolutely necessary. The radical left, knowing that the military probably would accept the legitimacy of a moderate left government, is content to bide its time, fully participate in the legal political process, and not provoke a military reaction. Nonetheless, a sequence of events that could lead to major gains by the radical left or a general breakdown is conceivable. Such a sequence would begin with the same event: the extreme left wins the election or APRA makes a sudden

and major shift to the left to win the election and gives indications it will follow highly radical policies. [redacted]

34. In this worst case scenario, two courses might occur at this point. The first is that, despite their statements to the contrary, military leaders permit the radical left forces to remain in power, either because the military is too divided to take action, or because the radical left succeeds in calming longstanding animosities and persuading military leaders that the armed forces will continue to receive all the resources they want. [redacted]

35. The second alternative course that might lead to higher levels of conflict and, possibly, expanded leftist influence would be the following sequence:

- The military reacts to an IU victory by launching a coup and severe fighting breaks out.
- The radical left takes advantage of growing resistance to initiate a new insurgency that begins to attract much broader support and participation than the *Sendero Luminoso* movement.
- This insurgency develops the potential to create supportive links with regional leftist insurgents and to attract Cuban and Soviet support. [redacted]

36. Either of the above outcomes would not only be disastrous in the long term for democracy in Peru and for US influence and security interests in the country, but they also could have a severely destabilizing impact on other parts of South America—notably Chile, Bolivia, Ecuador, and even possibly Colombia and Venezuela. Moreover, they also would provide potentially greater opportunities for the growth of Soviet and Cuban influence in Peru and perhaps in the hemisphere. [redacted]

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